STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2000-123

June 18, 2001

S.D. WARREN
Petition to Establish Power Purchase Agreement Rate for Sales of Energy and Capacity by Warren's Somerset Mill to Central Maine Power Company

ORDER REJECTING STIPULATION

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

Through this Order, we reject a stipulation intended to resolve the issues in this proceeding.

II. BACKGROUND

On February 9, 2000, S.D. Warren Company (Warren) filed a petition asking the Commission to establish the rate for the sales of energy and capacity from its Somerset Mill to Central Maine Power Company (CMP) for the one-year period beginning March 1, 2000. Warren currently sells the entire output of the Somerset Mill to CMP pursuant to a Power Purchase Agreement (PPA) that extends through October 2012. The Somerset Mill also purchases its entire electricity needs from CMP's system. The rate CMP pays Warren under the PPA is tied to the rates Warren pays CMP for electricity. The arrangement was intended to be essentially a financial "wash" in that CMP would pay Warren for power at a rate equal to the amounts Warren pays CMP for electric service.

Warren's February 9th petition is a result of the restructuring of the electric industry in Maine which prohibits utilities from providing generation services. Because CMP may no longer provide generation services, a question arises as to how the rate under the PPA should be established. In addition to Warren, CMP, the Public Advocate and the Industrial Energy Consumer Group (IECG) are parties to this proceeding.

During the pendency of this proceeding, the Legislature amended unallocated section 6 of the Restructuring Act to specify how the Commission should establish PPA rates in situations (such as the Somerset PPA) where pre-existing contracts tie power purchase rates to a utility's retail rates. P.L. 1999, ch. 730. Under unallocated section 6, the Commission is directed to establish the rates for the Somerset PPA as follows: 1) for the 12-month period beginning March 1, 2000, the rate is to be set by reference to the average total price paid for electric services by customers in Somerset's customer class; 2) for the 12-month period beginning March 1, 2001, the rate is to be set based on Somerset's transmission and distribution (T&D) charges and

the cost of its generation service (which must be obtained through a Commission approved process)[1]; 3) for the remaining years of the contract, the Commission may require CMP to sell the output of the Somerset Mill back to Somerset or otherwise act to place the parties as close as possible to their positions with respect to the PPA that existed prior to restructuring.

Subsequent to the amendment of unallocated section 6, our advisory staff and the parties met several times to discuss the implementation of the legislative directives which would involve obtaining information on the total electricity costs of all of CMP's 115 kV customers. After these discussions, the parties asked that the implementation efforts be delayed to allow an opportunity for settlement negotiations to occur. On March 20, 2001, CMP filed a stipulation that would resolve all the issues raised in the proceeding. The stipulation was executed by CMP, Warren and the Public Advocate. The IECG stated that it does not oppose the stipulation.

Under the stipulation, the price paid to Warren for the year beginning March 1, 2000 would be based on the average per kWh cost of T&D services plus the rate paid by Warren for competitive energy supply. This preserves a financial wash from Warren's perspective. The PPA rate in the second year (beginning March 1, 2001) would be established pursuant to the provisions of unallocated section 6. In the third year (beginning March 1, 2002), the rate would be set based on Warren's T&D and competitive supply costs, maintaining a financial wash to Warren. The stipulation provides for a third-year bid process with optional approaches intended to minimize the spread between the cost of competitive supply to Warren and the value of Warren's generation.[2]

III. DISCUSSION

When reviewing stipulations, the Commission considers whether: 1) the parties joining the stipulation represent a sufficiently broad spectrum of interests that the Commission can be assured that there is no appearance or reality of disenfranchisement; 2) the process that led to the stipulation was fair to all parties; and 3) the stipulated result is reasonable, in the public interest, and not contrary to legislative mandates. See Central Maine Power Company, Request for Alternative Rate Plan, Docket No. 99-666 (Nov. 16, 2000). In this instance, the stipulation is supported by both parties to the PPA, as well as the Public Advocate, who represents the interests of the general body of ratepayers. In addition, the stipulation is not opposed by the IECG, the only other party to this proceeding. Thus, we conclude that the stipulation is supported by a sufficiently broad spectrum of interests. We also conclude that the stipulation process was fair, in that all active parties had a reasonable opportunity to

[1] By Orders dated March 15, 2001 and September 5, 2000, the Commission approved the process and selection of Warren's power supplier.

[2] This spread represents stranded costs that will be paid by the general body of ratepayers.

participate in the settlement process. However, we must reject the stipulation because the stipulated result in two respects is not reasonable and would be contrary to legislative intent as reflected in unallocated section 6.

We reject the stipulation, as presented, with some reluctance. Using plausible assumptions about future prices, and the likely outcome of the price-seeking mechanisms described in the stipulation, the overall result appears to be fair to both ratepayers and Warren. Moreover, we appreciation the effort and creativity the stipulating parties have shown in bringing this proposal to us. Nevertheless, because the financial risk created by the current uncertain market is placed entirely on ratepayers' shoulders, we decline to approve the stipulation.

Unallocated section 6 provides that, for years beginning March 1, 2002, the Commission shall require that the Somerset Mill generation be sold or used in a manner that places the contracting parties as close as possible to their financial positions as existed prior to industry restructuring. This would occur by first minimizing to the greatest extent possible the spread between the cost of Warren's generation supply and the value of its generation output, and then, as further directed by unallocated section 6, by equitably apportioning any resulting costs and benefits between the parties.

CMP has indicated that the application of unallocated section 6 for the year beginning March 1, 2000 would result in Warren receiving approximately $3.5 to $4 million in PPA payments beyond that which would maintain a financial wash from Warren's perspective. As part of the stipulation, Warren agrees to forego any amount above a financial wash for the first year and is assured a financial wash in the third year (a result that would not necessarily occur under the provisions of unallocated section 6). In addition, the stipulation provides for optional bid processes designed to determine how to minimize the spread between the cost of Warren's supply and the value of its generation. CMP estimates that the spread should be in the $8 million range.

The first problem with the stipulation is that ratepayers have unlimited exposure to the cost spread. Under the stipulation, Warren foregoes approximately $3.5 to $4 million in the first year in return for a financial wash in the third year. As mentioned above, unallocated section 6 requires the cost spread to be equitably apportioned. If CMP is correct in its estimate that the spread would be in the $8 million range, the agreement would appear reasonable in that the cost spread can be viewed as equitably apportioned when taking into account the $3.5 to $4 million ratepayer benefit in year one. However, we can not be certain that the cost spread will be in the $8 million range. Because the wholesale electricity market in New England is in early development, it is impossible to be confident of any estimate of the outcome of the bid processes for Warren's generation and mill load. If the cost spread turns out to be substantially higher than the estimated $8 million, we cannot conclude that the stipulation is consistent with the legislative mandate that the cost spread be equitably apportioned. Furthermore, we note that while the potential downside risk for ratepayers could substantially exceed $8 million, the likelihood that the cost spread would be much less than $8 million appears small. Thus, we view the risk allocation in the stipulation to be asymmetric.

The second problem is that the stipulation provides Warren with the unilateral right to reject a bid option that may minimize the cost spread if it decides that the result would impose unacceptable constraints on Warren's operation of the Somerset Mill. Although Warren should be free to argue that the implementation of unallocated section 6 should not result in any "unacceptable" constraints on the Mill's operation, it is the Commission that has the authority to interpret and implement the statute so that the PPA rates are set consistent with legislative intent.

We note that the problems with the stipulation could be eliminated by providing for a cap on ratepayer exposure to the cost spread and by explicitly providing that the Commission has the ultimate authority to establish the PPA rates after considering any arguments regarding constraints on the operation of the Mill.[3]

The parties are directed to inform the Commission by **June 27, 2001**, whether a revised stipulation will be filed or whether the Commission should proceed to set the year one PPA rates pursuant to the statute. If a revised stipulation is not submitted, we request that CMP or Warren file a petition to establish the year three rates in the near future so there is sufficient time to plan for and implement the necessary bid process.

Accordingly, we

O R D E R

That the stipulation filed March 20, 2001 is, hereby, rejected.

Dated at Augusta, Maine, this 18th day of June, 2001.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

[3] It may be reasonable for Warren to have a unilateral right to refuse a bid option that it believes creates unacceptable constraints on Mill operations. However, the Commission must maintain the authority to set the PPA rate as if the bid option was accepted if its interpretation of unallocated section 6 leads to such a result.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.